

NYCAN

AR59

Wingspear Business Reference Room
University of Alberta
1-18 Business Building
Edmonton, Alberta T6G 2R6

1998 ANNUAL REPORT

Corporate Profile

Nycan Energy Corp. is a Canadian junior oil and gas company which explores for and produces petroleum and natural gas reserves in Alberta. The Company has shown steady growth through generating sound geological prospects, acquiring mineral rights and properties with untapped potential, and maximizing the production of reserves. A healthy balance sheet and sound financial policy are key elements in Nycan's corporate goal of enhancing value for shareholders.

Nycan Energy Corp. trades publicly on the Alberta Stock Exchange as "NYE". At December 31, 1998, there were 115 million shares outstanding.

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Annual Meeting

The Annual Meeting of Shareholders will be held at 3:30 p.m. on Wednesday, May 19, 1999, in the Cardium Room of the Calgary Petroleum Club, 319 - 5th Avenue S.W., Calgary, Alberta.

Financial and Operating Highlights

	1998	1997	% Change 1998 / 1997	1996
Financial				
Revenue (after Royalties)	\$ 2,304,256	\$ 1,604,317	+44%	\$ 1,299,126
Funds Flow from Operations	1,140,875	867,251	+32%	691,415
Funds Flow per Share	0.13	0.11	+18%	0.10
Net (Loss) Income	(49,415)	229,425	-122%	247,512
Net (Loss) Income per Share	(0.01)	0.03	-133%	0.04
Total Assets	9,965,907	7,538,238	+32%	4,507,602
Shareholders' Equity	\$ 5,723,318	\$ 4,578,074	+25%	\$ 3,608,038
Common Shares Outstanding				
Weighted Average	9,160,198	7,863,846	+16%	6,707,778
At Year End	11,487,374	8,605,150	+34%	7,780,080
Operations				
Oil and Ngls (bbls/d)	219	118	+86%	91
Natural Gas (mcf/d)	1,661	1,125	+48%	860
Exit Rate (boed)	450	350	+29%	235
Product Prices				
Oil (\$/bbl)	14.97	21.28	-30%	25.08
Natural Gas Liquids (\$/bbl)	17.57	23.27	-24%	23.00
Natural Gas (\$/mcf)	2.07	1.92	+8%	1.68
Undeveloped Land				
Gross Acreage	62,122	43,447	+43%	32,597
Net Acreage	14,917	10,239	+46%	7,510
Number of Wells Drilled	10	21	-52%	10

Message to Shareholders

1998 was a challenging year for the oil and natural gas industry. Unsettled global economies, especially in Asia, Russia and parts of South America resulted in reduced demand for commodities. Lower demand coupled with increasing supply caused prices for crude oil to fall to near record lows of \$11.50 US per barrel. On the other hand, due to expanded export pipeline capacity, Western Canadian natural gas now commands a favourable North American price of \$2.25 per thousand cubic feet.

Focus

Despite the volatile industry environment, Nycan did not waver from its focus of concentrating its efforts on developing prospects in Southern Alberta. We successfully implemented a transition to natural gas based exploration and reduced operating costs per unit of production by installing Company-owned production facilities in our core area.

Strategy

Early in 1998, Nycan completed drilling obligations on oil prospects at Turin, Turin East and Retlaw South. As new prospects were developed, Nycan was able to gain control of its destiny by assuming operatorship. The move to operatorship represents an important change in status for Nycan, allowing the Company to have more control over the timing and direction of its projects.

As the year progressed, gas projects moved to the forefront. The increased prices for uncontracted Alberta gas due to expanded pipeline capacity from Western Canada to Eastern U.S. markets provided the impetus for

Nycan to move into shallow gas exploration. As oil prices continued to deteriorate through the first quarter of 1998, the pressure to step up our shallow gas initiative escalated. A shallow natural gas trend concept was developed utilizing existing well control to identify gas zones overlooked by others. Lands were acquired along these trends, locations were identified, and late in the year, drilling commenced. Nycan took advantage of opportunities to negotiate for and acquire lands at Turin, Retlaw, Enchant, Iron Springs, Cherry and Louisiana Lakes.

Results

As a result of successful drilling activities, production volumes increased by 67% to average 385 boed in 1998 compared to 231 boed in 1997. Oil and natural gas liquids comprised 57% of the 1998 average yearly production volumes; however, by year end this had been reversed and natural gas accounted for 58% of the exit daily production volume. Nycan's 1998 exit volume was 450 boe, a 29% increase over the 1997 exit volume of 350 boe.

Despite a 30% decrease in oil prices, funds flow from operations increased 32% to \$1,140,875 in 1998 from \$867,251 in 1997. Capital expenditures for the year ended December 31, 1998 totalled \$4.2 million, compared to \$3.8 million expended in 1997. In excess of 40% of the capital or \$1.9 million was invested in facilities, primarily at Turin East. Drilling and completion capital expenditures totalled \$1.8 million, land and production acquisition costs were \$505,000, seismic programs cost a further \$33,000 and general and administrative costs were held to \$247,000.

Corporate

Two flow-through share private placements in 1998 resulted in an additional \$2,085,000 of working capital for the Company. In May 535,000 shares were issued for gross proceeds of \$535,000, and in December, \$1,550,000 was added to working capital through the sale of 2,297,222 shares.

In July 1998, Nycan relocated its banking business to Alberta Treasury Branches and established a \$ 2.0 million line of credit. Nycan used fixed-term financing to fund a portion of its production facility costs at Turin East and Retlaw.

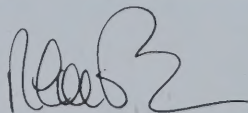
After receiving shareholder and regulatory approval in May 1998, Nycan completed the consolidation of its common shares on a four-to-one basis and changed its name to Nycan Energy Corp. All numbers contained in this report have been adjusted to reflect the consolidation. A new Normal Course Issuer bid was approved by the Alberta Stock Exchange in July and expires in July 1999. A total of 15,000 shares were purchased for cancellation in 1998.

In the first months of this year, the industry continued to reel from the impact of low oil prices. The optimism for a quick price recovery has given way to the reluctant acceptance of the status quo. Many companies are reacting to this by cutting capital budgets, reducing staff and concentrating on natural gas drilling. Companies are finding themselves over-leveraged and as a result are pursuing property dispositions and business combinations. As the year progresses, we anticipate more quality producing property packages will become

available for acquisition. Nycan has budgeted capital expenditures of \$31 million, which is anticipated to match our cash flow. Funds have been allocated for exploration and development drilling of shallow gas prospects in our core area of southeastern Alberta. We have a large inventory of drillable prospects which will keep us active throughout 1999 and into 2000.

Nycan's ability to maintain strong production and cash flow growth during a period of unprecedented contraction in the industry is a testimony to the dedicated team of employees and directors. If you have been a shareholder for any length of time, these names are by now familiar to you. May I once again extend my sincere "thank you" to Nycan's employees, Cliff Jeffrey, Tim Deschamps, Debra McPherson, consultants, Wayne Radcliffe, Susan Cartmell and Bob Lamond, Jr.; and Nycan's Directors, Bob Lamond, Tony Teare, Cliff Jeffrey, Tom Robinson, Leo Jegen, Pat McCarthy and Ian Henderson. I would also like to thank the shareholders for their support.

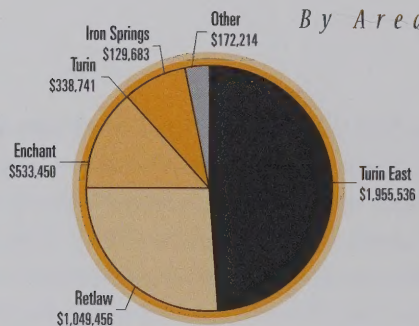
We welcome your comments during the year and look forward to continued increases in shareholder value.



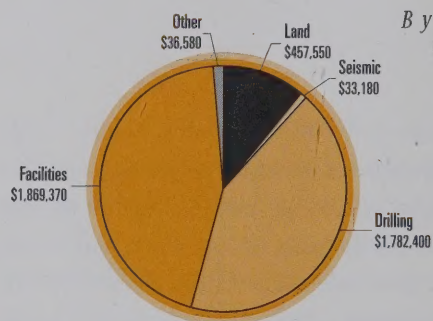
R.L. McPherson
President
April 5, 1999
Calgary, Alberta

Capital Expenditures

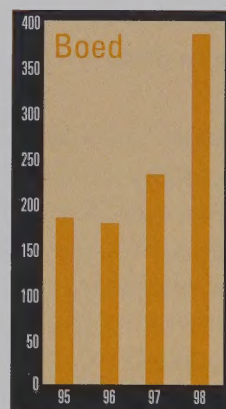
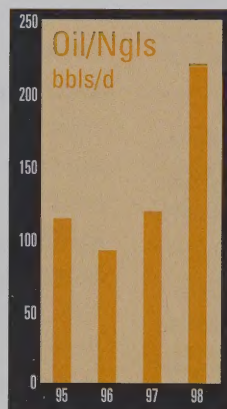
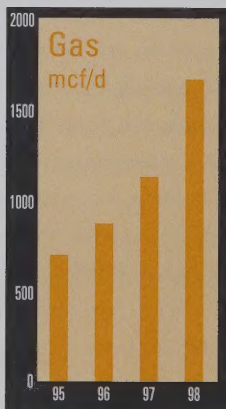
By Area



By Type



Daily Production



Cash Flow



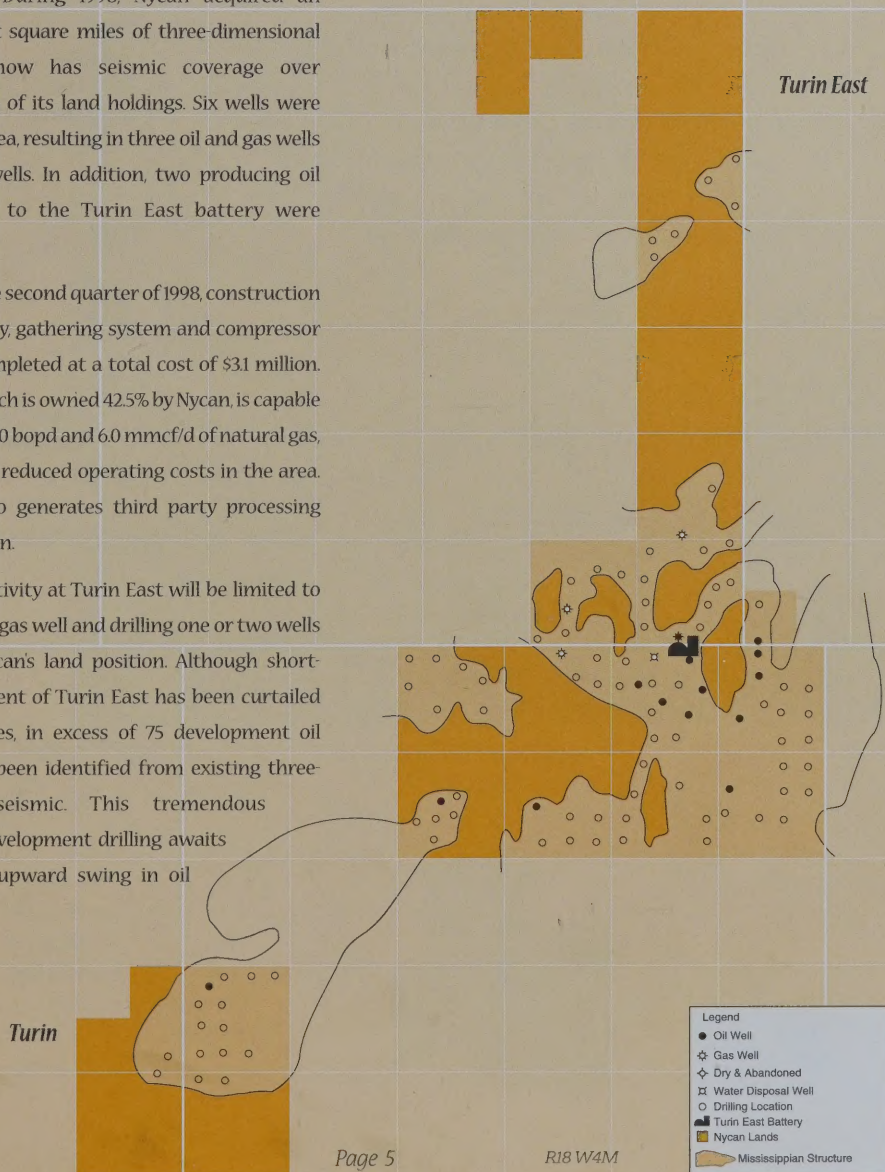
Exploration and Development

Southeastern Alberta Oil

Turin East is Nycan's largest producing area, accounting for approximately 60% of daily production volumes. During 1998, Nycan acquired an additional eight square miles of three-dimensional seismic and now has seismic coverage over essentially 100% of its land holdings. Six wells were drilled in this area, resulting in three oil and gas wells and three oil wells. In addition, two producing oil wells adjacent to the Turin East battery were purchased.

Late in the second quarter of 1998, construction of the oil battery, gathering system and compressor station was completed at a total cost of \$31 million. This facility, which is owned 42.5% by Nycan, is capable of processing 600 bopd and 6.0 mmcf/d of natural gas, and has greatly reduced operating costs in the area. The facility also generates third party processing income for Nycan.

In 1999, activity at Turin East will be limited to re-entering one gas well and drilling one or two wells to preserve Nycan's land position. Although short-term development of Turin East has been curtailed due to oil prices, in excess of 75 development oil locations have been identified from existing three-dimensional seismic. This tremendous inventory of development drilling awaits the inevitable upward swing in oil prices.



Southeastern Alberta Shallow Gas

As oil prices continued to decline through the first quarter of 1998, the pressure to step up our shallow gas initiative increased. This effort resulted in the Company acquiring land, purchasing producing wells and drilling or re-entering wells over eight shallow gas areas in Southeastern Alberta. Since the implementation of Nycan's shallow gas strategy, almost 17,000 acres of land have been acquired. Twelve wells have been drilled or purchased. Two million cubic feet per day of gas, net to Nycan, is currently being produced from nine of these wells and the remaining three await tie-in. Ultimately, an additional 30 wells will be drilled on these lands. It is expected that an average gas well on these prospects will produce half a billion cubic feet of natural gas and have an initial production rate of 500 mcf/d. At a cost of \$250,000 to drill, complete, equip and tie-in, these wells will payout in less than one year.

Iron Springs

Working Interest: 9% – 50%
 Operator: Nycan and others
 Landholdings: Net 3,580 acres
 Productive wells: 5
 Current production: Net 400 mcf/d
 Potential locations: 4

Retlaw

Working interest: 100%
 Operator: Nycan
 Landholdings: Net 4,160 acres
 Productive wells: 4
 Current production: 1.25 mmcf/d
 Potential locations: 3

Retlaw South

Working interest: 22% – 50%
 Operator: Nycan
 Landholdings: Net 820 acres
 Potential Locations: 5

Turin

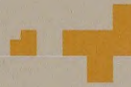
Working interest: 35% – 50%
 Operator: Nycan
 Landholdings: Net 1,020 acres
 Potential locations: 4

Oldman River

Lethbridge

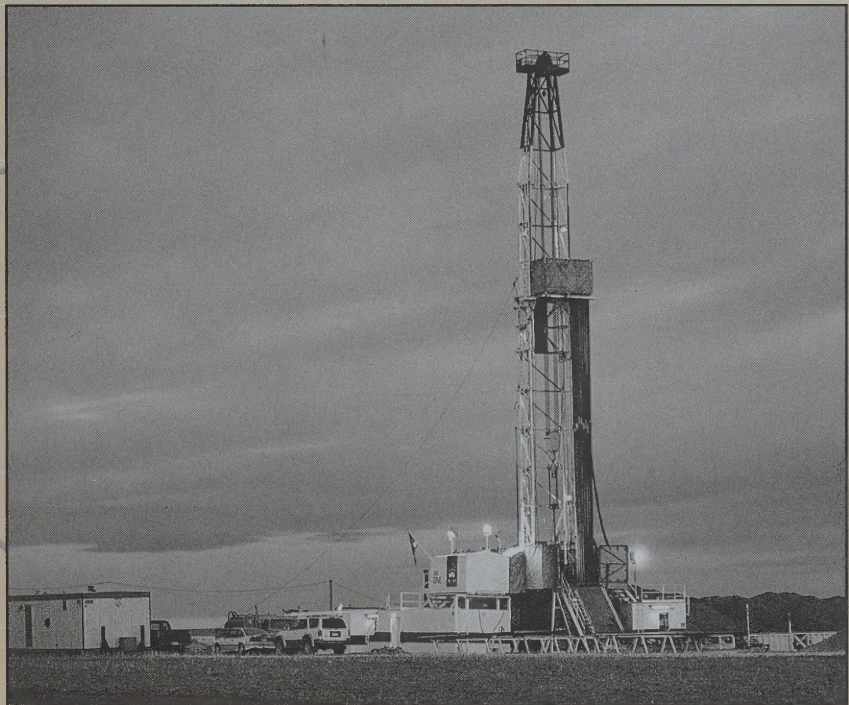
Louisiana Lakes

Working interest: 50%
Operator: Nycan
Landholdings: Net 1,360 acres
Wells: 1 shut-in gas well
Potential locations: 4



Enchant

Working interest: 12.5% – 50%
Operator: Nycan
Landholdings: Net 1,290 acres
Productive wells: 1
Current production: Net 400 mcf/d
Potential Locations: 5



Drilling rig at Enchant

Cherry

Working interest: 50%
Operator: Nycan
Landholdings: Net 2,000 acres
Wells: 1 shut-in gas well
Potential locations: 4



Reserves

Nycan's oil and natural gas reserves and associated net present value were evaluated by Ashton Jenkins & Associates Ltd. as of January 1, 1999 and are detailed in the following table:

The independent engineering report assumed an oil price per barrel of \$15.00 US in 1999 and \$17.34 US in 2000 and a heavy oil differential of \$10.00 Cdn per barrel in both years. Natural gas prices per thousand cubic feet were assumed to be \$2.25 in 1999 and \$2.10 in 2000.

	Gross Reserves			Net Reserves			Present Value		
	Oil (Mstb)	Ngls (Mstb)	Gas (Mmcf)	Oil (Mstb)	Ngls (Mstb)	Gas (Mmcf)	10% (\$000)	12%	15%
Proved Producing	324	51	4,049	274	41	3,267	6,541	6,201	5,765
Proved Non-Producing	57	3	1,480	49	1	1,262	1,213	1,123	1,006
Total Proved	381	54	5,529	323	42	4,529	7,754	7,324	6,771
Probable Additional	494	18	2,093	443	14	1,715	3,040	2,609	2,102
Total	875	72	7,622	766	56	6,244	10,794	9,933	8,873

Undeveloped Land

In a report dated January 1, 1999 by Seaton-Jordan & Associates, independent consultants, the market value of 14,917 net acres of undeveloped lands was estimated to be \$870,804. Subsequent to year end, Nycan has acquired an additional 8,500 net acres of undeveloped land at an average cost of \$2091 per acre.

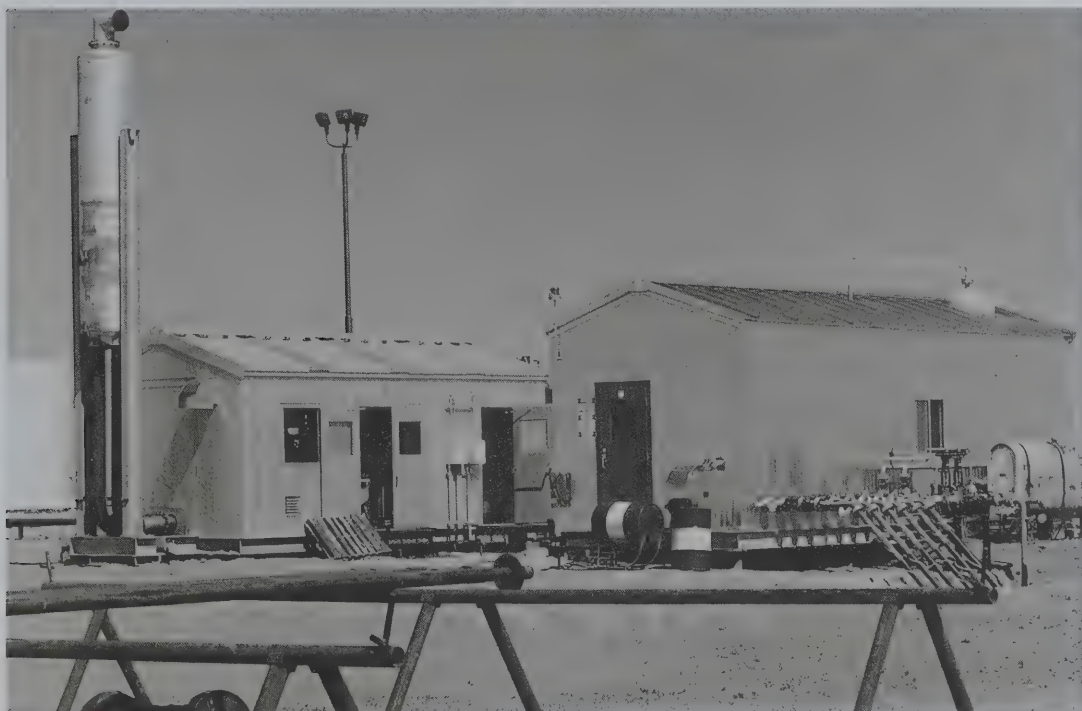
Outlook for 1999

Reduced drilling activity in Canada, and particularly in the United States, is expected to result in strong prices for natural gas this fall and winter. Notwithstanding the mild winter of 1998-1999, the competition for natural gas prospects has steadily increased this year and should continue to do so.

As the industry moved from oil to natural gas exploration, Nycan was able to exploit a small window of opportunity. During the first quarter of 1999, Nycan has been actively pursuing shallow natural gas on additional prospects. Successful wells have been drilled at Louisiana

Lakes, north of Suffield and at Cherry, south of Bow Island. Lands have been acquired at Sweetgrass and drilling will take place during the summer. All are at a shallow depth, have low capital costs, and are near the infrastructure required to transport and process the natural gas.

Funds have been allocated to drill wells at Louisiana Lakes, Cherry, Turin, Turin East, Enchant and Retlaw. We continue to work diligently to build a solid energy company for our shareholders and are enthusiastic about our 1999 exploration program.



Compressor at Turin East

Management's Discussion and Analysis

Summary

Despite lower crude oil prices, production growth resulted in a year of record cash flow for Nycan. Cash flow from operations increased by 32% to \$1,140,875 from \$867,251 in 1997. However, a 95% increase in depletion and depreciation expense due to increased finding and on-stream costs and higher production volumes resulted in a net loss of \$49,415 in 1998 compared to income of \$229,425 in 1997. Considering year end exit volumes and drilling plans for 1999, Nycan expects to achieve record cash flow again in 1999.

Revenues

Gross income increased by 40% to \$2,704,480 in 1998 from \$1,924,919 in 1997. Higher production volumes of both oil and natural gas contributed to this increase. Oil and natural gas liquids production averaged 219 barrels per day in 1998, an 86% increase from 118 barrels per day in 1997. Natural gas production increased 48% from 1.1 mmcf/d in 1997 to 1.7 mmcf/d in 1998. Most of the increase in production is attributable to start-up of the production facilities at Turin East.

Offsetting the substantial increase in production volumes was the decrease in the price Nycan received for its oil production. Nycan received, on average, \$14.97 per barrel of oil in 1998, a 30% decrease from the \$21.28 received in 1997. The price received for crude oil is based upon the Edmonton posted price, adjusted for transportation and crude oil quality. This quality adjustment or "differential" between light and heavy varied from a high of \$8.62 per barrel in January 1998 to a low of \$3.43 per barrel in December 1998 and averaged \$5.71 per

barrel for the year versus an average of \$6.75 per barrel in 1997. This differential has continued to drop in 1999 and was \$1.69 in February. Nycan's overall production of crude oil is of a medium quality and therefore the net field price received is dependent upon not only the Edmonton posted price but the quality differential.

Nycan's natural gas prices in 1998 averaged \$2.07 per mcf, an 8% increase from \$1.92 per mcf in 1997. The majority of Nycan's natural gas production is sold on the spot market. Due to a lack of production history associated with much of its natural gas production, Nycan has been unwilling to risk fixing the price on a large percentage of its daily production. However, approximately 10 mmcf per day has been committed to be sold at a price of \$2.94 per mcf until March 31, 1999 and at \$2.65 per mcf from April 1, 1999 to October 31, 1999. An additional 700 mcf per day has been sold at a price of \$2.53 per mcf until March 31, 1999.

Income from facilities was \$91,630 in 1998 compared to \$28,078 received in 1997. Facility income is expected to increase in 1999 due to additional third party volumes being processed at the Turin East Facility.

Royalties

Due to high production levels, net royalties increased 38% to \$310,224 from \$224,503. Royalties as a percentage of revenues remained constant at 12%.

	1998	1997	% Change
Crown royalties	\$145,816	\$214,702	(32)
Freehold royalties	176,764	84,574	109
Other royalties	77,646	21,326	264
ARTC	(90,000)	(96,099)	(6)
	\$310,226	\$224,503	38

Crown royalty and ARTC rates are a function of commodity prices, resulting in lower Crown royalty rates and lower ARTC rates when commodity prices decrease. Lower prices for oil in 1998 compared to 1997 therefore led to lower overall rates for 1998. Nycan's property at Turin East is primarily freehold land which accounts for the high percentage of freehold royalties. Most of Nycan's 1999 exploration and development program will be conducted on Crown lands and therefore it is anticipated that the percent paid to the Crown and ARTC will increase.

Production Expense

Production costs increased by 50% to \$791,083 in 1998 from \$528,425 in 1997. This increase was the result of higher production volumes. On a barrel of oil equivalent basis, Nycan had a 12% decrease in production costs from \$6.27 per boe in 1997 to \$5.63 per boe in 1998, primarily as a result of the installation of facilities at Turin East.

General and Administrative

General and administrative expense increased from \$170,325 in 1997 to \$246,800 in 1998. Higher compensation paid to the senior executives was the major addition. On a boe basis, general and administrative costs were lowered by 27 cents per barrel in 1998 from 1997. It is

anticipated that additional staff will be required due to increased production growth and operatorship; however, it is also expected that we will continue to reduce general and administrative costs on a unit-of-production basis.

Depletion and Depreciation

In 1998, Nycan's depletion and depreciation rates rose to \$8.85 per boe from \$7.56 per boe in 1997. The increased per unit rate of depletion and depreciation was due to increased finding and on-stream costs incurred in 1998, particularly those costs associated with the installation of facilities at Turin East and Retlaw. Also contributing to this higher per unit rate was a downward revision in the estimate of recoverable gas reserves at Retlaw, Joffre and Markerville. In total, depletion and depreciation increased 95% in 1998 to \$1,243,073 from \$637,826 in 1997 due to the 677% increase in production volumes and the increased depletion and depreciation rate.

Companies following the full cost method of accounting must also perform a "ceiling test" analysis on an annual basis. This test limits the net book value of property, plant and equipment to the estimated future net revenues from proven reserves based upon then prevailing prices. Nycan used December 31, 1998 prices of \$2.40 Cdn per mcf of natural gas and \$13.00 Cdn per barrel of oil. Nycan has a "ceiling test" surplus and therefore no write down of the carrying value of the assets was required.

Interest on Long-Term Debt

Nycan increased costs associated with its bank and facility funding arrangements to \$125,498 in 1998 from \$31,483 in 1997. The largest component of this increase was interest costs associated with the use of our bank line of credit which increased from \$22,462 in 1997 to \$93,941 in 1998. Approximately \$20,000 was expended on application and renewal fees which are not expected to be recurring. Interests costs for 1999 are projected to be similar to those incurred in 1998.

Capital Expenditures

Capital expenditures, net of dispositions, increased in 1998 by 28% to \$4,104,080 from \$3,222,646 in 1997. In 1998 the largest component, \$1,870,624, was spent on facilities, followed by \$1,783,630 expended on drilling and completion costs. By contrast in 1997, \$2,277,860 was expended on drilling and completion costs, \$623,281 on geological and geophysical and \$469,086 on facilities. Dispositions in 1998 netted \$75,000 versus \$615,000 received from the sale of the Little Bow property in 1997.

Income Taxes

Nycan has approximately \$6.5 million in tax pools with which to shelter taxable income in future years. At current rates of capital expenditures, Nycan does not anticipate being taxable for several years.

Liquidity and Capital Resources

Nycan has a \$2.0 million revolving line of credit of which \$257,725 was outstanding at December 31, 1998. This credit facility carries an interest rate of prime plus $\frac{3}{4}\%$ and is secured by a \$5.0 million demand debenture and a first floating charge on all of the assets of the Company.

The loan is structured to be repayable on demand but Nycan has been assured by the bank that they foresee no reason to call the loan within the next twelve months and it has therefore been classified as long-term debt.

During 1998 Nycan entered into three separate fixed term facility financing arrangements.

During 1998, Nycan issued a total of 2,847,224 flow through shares for gross proceeds of \$2,105,625. 15,002 shares were issued at \$1.33 per share, 535,000 shares at \$1.00 per share and 2,297,222 shares at \$0.675 per share. In addition, pursuant to the exercise of stock options, 50,000 shares were issued at a price of \$0.60 per share.

Nycan entered into Loans 1 and 2 on behalf of itself (85%) and for that of a joint interest partner (15%). The numbers reflected here are net to Nycan's account. Nycan has taken security by way of a promissory note and registered such security against the partner's interest in the facility.

	Initial Amount	Amount Outstanding December 31, 1998	Term	Interest Rate	Monthly Payment
Loan 1	\$552,500	\$522,543	60 months	7.75%	\$11,105
Loan 2	\$104,975	\$100,432	44 months	8.30%	\$2,769
Loan 3	\$208,000	\$201,035	48 months	7.25%	\$5,019

Year 2000

Nycan has addressed the Y2K computer issue, being the ability of computers and embedded chips to properly function and process data during the 20th to 21st Century change. Nycan is satisfied that its internal

systems and those of its direct service providers, such as accounting services, are Y2K compliant. In addition, the Company is satisfied that field equipment operated by it is Y2K compliant. Nycan has not obtained unqualified advice from the operators of its non operated properties that the operators' systems and operated field equipment are Y2K compliant; nor has Nycan obtained unqualified advice from the buyers of its production and major transporters that their systems and equipment are Y2K compliant. In addition, the operations of Nycan, both operated and non operated, may be affected by interruptions in basic services such as electricity and telephone which are beyond the ability of Nycan to assess. The Company currently has no reason to believe

that its costs associated with Year 2000 compliance for its operated systems will be significant but is unable to assess potential costs for Y2K compliance of non operated systems. Nycan is unable to fully determine the consequences if the applications of the operators of its non operated properties, product buyers and transporters or suppliers of basic services are not Y2K compliant. The potential impact of such applications not being compliant could range from inconvenience, such as a delay in the receipt of revenues, to a complete shut down of production for an indeterminable period. The Company is unable to economically insure against possible losses.



Facilities at Turin East

Auditors' Report

To the Shareholders of Nycan Energy Corp. (formerly Nycan Petroleum Corp.)

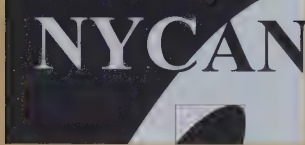
We have audited the balance sheets of Nycan Energy Corp. (formerly Nycan Petroleum Corp.) as at December 31, 1998 and 1997 and the statements of operations and retained earnings and changes in financial position for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 1998 and 1997 and the results of its operations and the changes in its financial position for the years then ended in accordance with generally accepted accounting principles.



Chartered Accountants
Calgary, Alberta
March 17, 1999



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Balance Sheet

	December 31	
	1998	1997
Assets		
Current assets		
Accounts receivable	\$ 677,831	\$ 773,843
Notes receivable (Note 2)	51,618	48,000
	729,449	821,843
Notes receivable (Note 2)	148,319	90,000
Cash in escrow (Note 5)	-	462,115
Property, plant and equipment, net (Note 3)	9,088,139	6,164,280
	\$ 9,965,907	\$ 7,538,238
Liabilities		
Current liabilities		
Accounts payable	\$ 1,097,676	\$ 1,506,660
Current portion of long-term debt	190,710	-
	1,288,386	1,506,660
Long-term debt (Note 4)	1,000,961	425,392
Deferred income taxes	1,832,666	958,974
Future site restoration liability	120,576	69,138
Shareholders' Equity		
Share capital (Note 5)	4,939,132	3,739,802
Retained earnings	784,186	838,272
	5,723,318	4,578,074
	\$ 9,965,907	\$ 7,538,238

Approved by the Board

Director
R. L. McPherson

Director
C. A. Teare



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Statement of Operations and Retained Earnings

	Year ended December 31	
	1998	1997
Revenues		
Oil and gas production, net	\$ 2,304,256	\$ 1,604,317
Expenses		
Production	791,083	528,425
General and administrative	246,800	170,325
Interest on long-term debt	125,498	31,483
Preferred share dividends (Note 5)	-	6,833
Depletion and depreciation	1,243,073	637,826
	2,406,454	1,374,892
Income (loss) before income tax	(102,198)	229,425
Deferred income tax recovery (Note 8)	52,783	-
Net (loss) income	(49,415)	229,425
Retained earnings at beginning of the year	838,272	618,662
Share repurchase (Note 5)	(4,671)	(9,815)
Retained earnings at end of the year	\$ 784,186	\$ 838,272
(Loss) earnings per share	\$ (0.01)	\$ 0.03



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Statement of Changes in Financial Position

	Year ended December 31	
	1998	1997
Cash (used in) provided by operating activities		
Net (loss) income	\$ (49,415)	\$ 229,425
Add: Non-cash items		
Depletion and depreciation	1,243,073	637,826
Deferred income taxes	(52,783)	-
Funds flow from operations	1,140,875	867,251
Net change in non-cash working capital components, excluding current portions of notes receivable and long-term debt	(312,972)	1,036,006
Cash provided by operating activities	827,903	1,903,257
Cash provided by (used in) investing activities		
Disposal of property, plant and equipment	75,000	615,000
Acquisition of property, plant and equipment	(4,179,080)	(3,837,646)
Repayment (issuance) of notes receivable	(61,937)	48,000
Cash in escrow	462,115	(462,115)
Site restoration costs	(11,414)	-
Cash used in investing activities	(3,715,316)	(3,636,761)
Cash provided by (used in) financing activities		
Increase in loans	766,279	425,392
Issuance of common shares	2,121,134	780,976
Redemption of preferred shares	-	(120,000)
Flow through shares to be issued	-	462,115
Cash provided by financing activities	2,887,413	1,548,483
Net decrease in cash	-	(185,021)
Cash at beginning of the year	-	185,021
Cash at end of the year	\$ -	\$ -
Funds flow from operations per share	\$ 0.13	\$ 0.11

Notes to Financial Statements

1. Accounting policies

Property, plant and equipment

The Company follows the full cost method of accounting for petroleum and natural gas operations, whereby all costs of exploring for and developing petroleum and natural gas reserves are capitalized. Costs include land acquisition costs, geological and geophysical costs, carrying charges on non-productive properties, costs of drilling both productive and non-productive wells and related overhead charges. The capitalized costs are depleted using the composite unit-of-production method based upon estimated proved reserves before royalties.

The capitalized costs less accumulated depletion and depreciation, deferred taxes, and the future site restoration liability are limited to an amount equal to the estimated future net revenues from proved reserves based on current prices and costs, plus the lower of cost and estimated fair value of unproven properties, less estimated future general and administrative expenses, financing costs, income taxes and future site restoration costs.

Proceeds from the sale of oil and gas properties are applied against capital costs, with no gain or loss recognized, unless such a sale would significantly alter the rate of depletion and depreciation.

Future reclamation costs

Estimated future dismantlement and site restoration costs for conventional oil and gas assets are provided using the unit of production method. The expense is included in depreciation and depletion.

Joint ventures

Most of the Company's exploration, development and production activities are conducted jointly with others. The accounts reflect only the Company's proportionate interest in such activities.

Hedging activities

Gains or losses on forward sales which have been arranged as a hedge against commodity price fluctuations are reflected in the product revenue at the time of sale of the related hedged production.

Comparative figures

Per share figures have been restated to conform with the 1998 financial statement presentation.

2. Notes receivable

(a) The Company has extended non-interest bearing share purchase loans of \$90,000 (1997 - \$138,000) to an employee who is also a director. The loans are evidenced by notes receivable and are secured by the shares issued. This loan is repayable at \$30,000 per year over the next three years.

(b) The Company financed a portion of a corporation's (owned by an employee of Nycan) construction of jointly owned production facilities. At December 31, 1998, this corporation owed the Company \$109,937 (of which \$21,618 is current) pertaining to the production facilities. It is management's intention that payments received from such

corporation will be used to pay down the long-term debt of the Company (see Note 4) that relates to the facilities. This financing carries interest rates of 7.75% and 8.30% (in parallel with the Company's loans to which the financing relates) and is secured by such corporation's undivided interest in the facilities.

3. Property, plant and equipment

December 31	1998	1997
Petroleum and natural gas properties, at cost	\$ 12,964,172	\$ 8,848,678
Accumulated depletion and depreciation	3,876,033	2,684,398
	\$ 9,088,139	\$ 6,164,280

The above amount includes property, plant and equipment of approximately \$2,762,000 which is not deductible for income tax purposes.

Unproved property costs of \$590,000 (1997 - \$698,000) have been excluded from assets subject to depletion.

In applying the full cost ceiling test, base prices of \$13.00/bbl and \$2.40/mcf were used for oil and natural gas, respectively.

Administrative expenses related to exploration activities were capitalized as part of petroleum and natural gas properties and amounted to \$67,068 in 1998 (1997 - \$54,098).

4. Long-term debt

(a) The Company has a \$2,000,000 secured revolving production loan, of which \$257,725 was outstanding at December 31, 1998 (1997 - \$425,392), with a Canadian financial institution. The facility carries an interest rate of prime plus 3/4 of 1%, is payable on demand and is subject to annual review by May 31, 1999. Required principal payments are not anticipated in 1999.

The loan is secured by an interest in certain property, a general assignment of book debts and a \$5,000,000 first floating charge demand debenture.

(b) The Company has two term facility loans with a Canadian financial institution of which balances of \$614,756 and \$118,155 (current portion \$113,087 and \$30,423, respectively) were outstanding at December 31, 1998. The loans carry interests rates of 7.75% and 8.30%, respectively and are secured by liens on the facilities.

(c) The Company has a term loan with a financial institution with a balance of \$201,035 (current portion \$47,200) that carried an interest rate of 7.25%. This loan is secured by liens on certain facilities.

(d) Repayment commitments on outstanding loans over the next five years are as follows:

1999	\$	190,710
2000	\$	205,954
2001	\$	222,418
2002	\$	209,872
2003	\$	104,992

5. Share capital

Authorized

Unlimited number of Common shares

Unlimited number of Class A Preferred shares without nominal or par value

Unlimited number of Class B Preferred shares without nominal or par value

	Number	Amount
Common shares		
Issued		
Balance at December 31, 1996	31,120,320	\$ 2,989,376
Conversion of Class D preferred shares (a)	800,002	120,000
Pursuant to flow through share agreements, net of related tax effect	1,510,856	376,272
Normal course issuer bid (b)	(37,500)	(4,630)
Flow through shares to be issued, net of related tax effect (c)	1,026,922	258,784
Balance at December 31, 1997	34,420,600	3,739,802
4 to 1 share consolidation (d)	8,605,150	3,739,802
Pursuant to flow through share agreements, net of related tax effect (e)	2,847,224	1,175,621
Exercise of options (f)	50,000	30,000
Normal course issuer bid (b)	(15,000)	(6,291)
Balance at December 31, 1998	11,487,374	\$ 4,939,132



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(a) On September 1, 1997, the Company converted the 1,200 Class D, Series 2 preferred shares outstanding and issued 800,002 Class A common shares. The Class D, Series 2 shares were convertible, redeemable, retractable, non-voting shares having a redemption price of \$100 and convertible at a ratio of 667 Class A shares for each Class D, Series 2 share, and having quarterly dividends at an annual rate of \$8.50 per share.

(b) In 1997, the Company established a normal course issuer bid that enabled the Company to repurchase up to 1,556,016 of its issued and outstanding common shares on the open market through the facilities of The Alberta Stock Exchange. The bid expired on July 28, 1998. During the year ended December 31, 1997, the Company repurchased and cancelled 37,500 common shares pursuant to the bid at a cost of \$14,445, \$4,630 of which reduced share capital and \$9,815 of which reduced retained earnings.

The Company has established a normal course issuer bid that will enable the Company to repurchase up to 270,642 of its issued and outstanding common shares on the open market through the facilities of The Alberta Stock Exchange. The bid expires on July 29, 1999. During the year ended December 31, 1998, the Company repurchased and cancelled 15,000 common shares pursuant to the bid at a cost of \$10,962, \$6,291 of which reduced share capital and \$4,671 of which reduced retained earnings.

(c) The Company reserved 1,026,922 shares for issuance pursuant to a flow through investment agreement dated December 1997. Pursuant to the agreement, proceeds of \$462,115 were deposited with the Company's solicitors, and held in escrow until the Company has incurred resource expenses that were renounced pursuant to the Income Tax Act (Canada). Subsequent to December 31, 1997, the Company incurred such expenditures, the funds were released from escrow and the shares issued. The Company had, effective December 31, 1997, renounced the related resource expenditures of \$462,115.

(d) On May 27, 1999, the Company consolidated its common shares on a 4 to 1 basis.

(e) In 1998, the Company issued 2,847,224 flow through shares. The before tax proceeds of \$2,105,625 will be renounced effective December 31, 1998. At December 31, 1998, the Company had expended \$659,988 of the proceeds and are committed to spend the remaining \$1,445,637 in 1999.

(f) During 1998, 50,000 options were exercised and 25,000 expired. At December 31, 1998, 475,000 common shares were reserved in respect of options granted to directors, officers and employees to acquire common shares at \$0.60 per share. These options expire between July 7, 1999 and March 25, 2001.

6. Financial instruments

The Company's financial instruments that are included in the balance sheet are comprised of accounts receivable and all current liabilities and long-term borrowings.

(a) Gas hedges

At December 31, 1998, the following fixed price contracts were in effect:

Volume	Fixed price	Time period
1,000 mcf/d	\$ 2.94	January 1, 1999 - March 31, 1999
1,000 mcf/d	\$ 2.65	April 1, 1999 - October 31, 1999
700 mcf/d	\$ 2.53	January 1, 1999 - March 31, 1999

At December 31, 1998, there was an unrealized gain of \$110,000 with respect to these contracts, relative to market prices at that time.

(b) Fair values of financial assets and liabilities

The fair values of financial instruments that are included in the balance sheet, including long-term borrowings, approximate their carrying amount due to the short-term maturity of those instruments and the floating prime rate applied to long-term borrowings.

(c) Credit risk

A substantial portion of the Company's accounts receivable are with customers in the oil and gas industry and are subject to normal industry credit risks.

7. Commitments

The Company has committed to future minimum payments under an operating lease covering office facilities as follows:

1999	\$ 53,770
2000	\$ 53,770
2001	\$ 35,847

8. Income taxes

The provision for income taxes in the statement of income and retained earnings varies from the amount that would be computed by applying the expected tax rate of 44% (1997 - 44%) to income before income taxes. The principal reasons for differences between such expected income tax expense and the amount actually recorded are as follows:

Year ended December 31	1998	1997
Computed expected income tax expense (recovery)	\$ (44,968)	\$ 100,947
Increase (decrease) in income taxes resulting from		
Preferred share dividends	-	3,007
Non-deductible royalties, taxes, lease rentals and depletion	89,077	111,338
Federal resource allowance	(57,292)	(65,580)
Alberta royalty tax credit	(39,600)	(42,284)
Recognition of prior years' tax losses not previously recognized	-	(107,428)
Income tax recovery	\$ (52,783)	\$ -

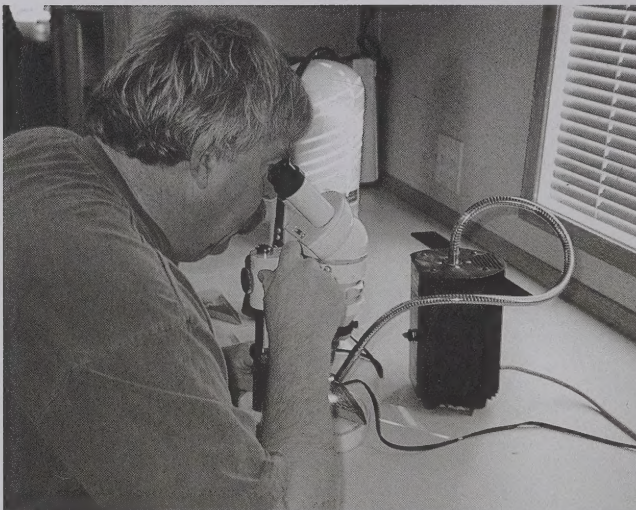
The Company has the following tax deductions at December 31, 1998 available to reduce future taxable income:

Canadian oil and gas property expense	\$ 841,542
Canadian development expense	1,795,028
Canadian exploration expense	494,547
Undepreciated capital cost	2,611,688
Foreign exploration and development expense	747,229
	\$ 6,490,034

Certain of these deductions are 'streamed' and therefore, their deductibility is dependent upon earning income from specific properties.

9. Uncertainty due to the Year 2000 Issue

The Year 2000 Issue arises because many computerized systems use two digits rather than four to identify a year. Date-sensitive systems may recognize the year 2000 as 1900 or some other date, resulting in errors when information using year 2000 dates is processed. In addition, similar problems may arise in some systems which use certain dates in 1999 to represent something other than a date. The effects of the Year 2000 Issue may be experienced before, on, or after January 1, 2000, and, if not addressed, the impact on operations and financial reporting may range from minor errors to significant systems failure which could affect an entity's ability to conduct normal business operations. It is not possible to be certain that all aspects of the Year 2000 Issue affecting the entity, including those related to the efforts of customers, suppliers, or other third parties, will be fully resolved.



Observing drill cuttings

Abbreviations

<i>bbls</i>	<i>barrels</i>
<i>bbls/d</i>	<i>barrels per day</i>
<i>boed</i>	<i>barrels of oil equivalent per day</i>
<i>bopd</i>	<i>barrels of oil per day</i>
<i>mcf</i>	<i>thousand cubic feet</i>
<i>mcf/d</i>	<i>thousand cubic feet per day</i>
<i>mmcf</i>	<i>million cubic feet</i>
<i>mstb</i>	<i>thousand stock tank barrels</i>
<i>ngls</i>	<i>natural gas liquids</i>



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Reserve Engineering Consultants

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